

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Tony L. Hammond; and
Nanci E. Langley

Competitive Product Prices
Inbound Competitive Multi-Service Agreements
with Foreign Postal Operators
China Post Group–United States Postal Service
Multi-Product Bilateral Agreement (MC2010-34)
Negotiated Service Agreement

Docket No. CP2011-68

ORDER CONCERNING AN ADDITIONAL INBOUND COMPETITIVE MULTI-SERVICE
AGREEMENTS WITH FOREIGN POSTAL OPERATORS 1
NEGOTIATED SERVICE AGREEMENT

(Issued September 16, 2011)

I. INTRODUCTION

The Postal Service seeks to add a specific agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 established in Docket No. MC2010-34. For the reasons discussed below, the Commission approves the proposed agreement.

II. BACKGROUND

On August 16, 2011, the Postal Service filed a notice, pursuant to 39 CFR 3015.5, that it has entered into an additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1.¹ The Notice concerns the inbound portion of a Multi-Product Bilateral Agreement with China Post Group (China Post 2011 Agreement) that the Postal Service seeks to add to the Inbound Competitive Multi-Service Agreements with the Foreign Postal Operators 1 product.

In Order No. 546, the Commission approved the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product and a functionally equivalent agreement, Koninklijke TNT Post BV and TNT Post PakketService Benelux BV (TNT Agreement). The Postal Service asserts that its filing demonstrates that the China Post 2011 Agreement fits within the Mail Classification Schedule (MCS) language in Governors' Decision No. 10-3 originally filed in Docket Nos. MC2010-34 and CP2010-95. The Notice states that the Commission recognized the Postal Service's intent to add other functionally equivalent agreements to the Competitive Multi-Service Agreements product. Notice at 2. The Notice also states that for other competitive products, the Commission has authorized functionally equivalent agreements to be included within the product, provided that they meet the requirements of 39 U.S.C. 3633.²

The Postal Service contends that the China Post 2011 Agreement to deliver inbound Air Parcel Post (Air CP), Surface Parcel Post (Surface CP) and Express Mail Service (EMS) in the United States is functionally equivalent to the agreement to deliver inbound Air CP, Surface CP, and EMS in the TNT Agreement.

¹ Notice of United States Postal Service of Filing Functionally Equivalent Inbound Competitive Multi-Service Agreement with a Foreign Postal Operator, August 16, 2011 (Notice). See also Docket Nos. MC2010-34 and CP2010-95, Order Adding Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 to the Competitive Product List and Approving Included Agreement, September 29, 2010 (Order No. 546).

² See Docket No. CP2009-50, Order Granting Clarification and Adding Global Expedited Package Services 2 to the Competitive Product List, August 28, 2009 (Order No. 290).

The Postal Service filed supporting materials including Governors' Decision No. 10-3, a redacted copy of the agreement, and an application for non-public treatment of materials filed under seal.

The Postal Service states it intends for the effective date for the rates for inbound Air CP, Surface CP, and EMS to be January 1, 2012.³ *Id.* at 3, Attachment 1 at 2. It maintains that the rates in the agreement are intended to remain in effect for one year from the effective date unless terminated sooner. *Id.* at 3-4.

The Notice advances reasons why the China Post 2011 Agreement fits within the MCS language for Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product and is substantially similar to the inbound portion of the TNT Agreement based on the products being offered and the agreement's cost characteristics. *Id.* at 5-8. The Postal Service identifies differences that distinguish the instant agreement from the TNT Agreement. *Id.*

The Postal Service asserts that the China Post 2011 Agreement and the TNT Agreement incorporate the same cost attributes and methodology and the relevant cost and market characteristics are similar, if not the same, for the China Post 2011 Agreement and the TNT Agreement. *Id.* at 8. Despite some differences, the Postal Service asserts that the China Post 2011 Agreement is “functionally equivalent in all pertinent respects” to the TNT Agreement previously filed. *Id.* (Footnote omitted.)

The Postal Service concludes that the China Post 2011 Agreement complies with 39 U.S.C. 3633 and is functionally equivalent to the TNT Agreement. Therefore, it requests that the Commission add the China Post 2011 Agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. *Id.* at 8.

³ Article 22 of the China Post 2011 Agreement provides that if an effective date for the settlement rates for EMS in the China Post 2011 Agreement is established, the China Post–United States Bilateral Agreement that was approved in Docket Nos. MC2010-13 and CP2010-12 will terminate at 11:59 p.m. on the day prior to the effective date of the settlement rates for EMS in the China Post 2011 Agreement. Notice at 3-4 n.6; *id.* Attachment 1 at 6.

In Order No. 817, the Commission gave notice of the docket, appointed a Public Representative, and provided the public with an opportunity to comment.⁴ On August 30, 2011, Chairman's Information Request No. 1 sought clarification of various elements related to the proposed rates and terms of the China Post 2011 Agreement.⁵ The Postal Service responded to CHIR No. 1 on September 6, 2011.⁶

III. COMMENTS

Comments were filed by the Public Representative.⁷ No other interested person submitted comments. The Public Representative states that because its terms are not sufficiently similar, the China Post 2011 Agreement is not functionally equivalent to the TNT Agreement. *Id.* at 2. He also contends that the China Post 2011 Agreement modifies the financial model used in the China Post 2010 Agreement in order to achieve cost coverage that complies with 39 U.S.C. 3633.

The Public Representative reviews the contract's functional equivalence with the TNT Agreement in Docket No. CP2010-95 and compliance with 39 U.S.C. 3633(a). *Id.* at 2-6. He observes several differences between the TNT Agreement and the instant agreement, some that are minor and others that cause the agreements not to be functionally equivalent. The Public Representative states that changes including the title, address, customs inspection and presorting are minor changes that do not affect functional equivalence. However, he argues that specific differences alter the China Post 2011 Agreement's functional equivalency including the option noted in Annex 1 that allows alternate rates for inbound EMS under the agreement, uncertainty in the

⁴ Notice and Order Concerning Filing of an Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, August 22, 2011 (Order No. 817).

⁵ Chairman's Information Request No. 1, August 30, 2011 (CHIR No. 1).

⁶ Response of the United States Postal Service to Chairman's Information Request No. 1, September 6, 2011 (Response to CHIR No. 1).

⁷ Public Representative Comments on Postal Service Notice of Filing Additional Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement, August 29, 2011 (PR Comments).

applicability of service performance metrics, development of “accounting business rules” applicable to the financial settlement process, and execution of a separate accord to determine the effective date. The Public Representative also asserts that additional licensing requirements for intellectual property may impact revenues or costs and are substantial differences. *Id.* at 3-4.

The Public Representative asserts that the China Post 2011 Agreement’s financial model differs from the TNT Agreement’s model and, as a result, the contract may not meet the requirements of 39 U.S.C. 3633. *Id.* The Public Representative contends that the lower contingency factor in the China Post 2011 Agreement appears to be “a plug figure intended to produce a cost coverage in excess of 100 percent.” *Id.* at 5. He also questions the reliability of the volume estimates, noting that if certain volumes exceed the estimates, costs would exceed revenues. *Id.*

The Public Representative notes the financial model’s inclusion of a method for calculating pay-for-performance penalties associated with late delivery and late or missing information. *Id.* 5-6. He also states that the supporting documentation does not address the impact of the lower contingency factor on anticipated EMS revenues. The Public Representative concludes that the Commission should not add the instant agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. He recommends that the China Post 2011 Agreement be made a new product in this or a future proceeding and that the Postal Service provide clarification of its financial model. *Id.* at 6.

IV. COMMISSION ANALYSIS

The Postal Service proposes to add an additional agreement under the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product. First, the Commission reviews the agreement to ensure that it is substantially equivalent to the agreement approved in Docket No. CP2010-95, and thus belongs as part of the Inbound Competitive Multi-Service Agreements with the Foreign Postal Operators 1

product. Second, the Commission must ensure that the contract at issue in this proceeding satisfies the requirements of rules 3015.5 and 3015.7, and 39 U.S.C. 3633.

Functional equivalence. The Postal Service states that the agreement shares similar cost and market characteristics with the TNT Agreement. It asserts that the instant agreement meets the pricing formula and classification established in Governors' Decision No. 10-3 which comport with 39 U.S.C. 3633 and the Commission's rules. The Postal Service states that the instant agreement's terms differ from the agreement in Docket No. CP2010-95, e.g., different foreign postal operators, execution of a separate accord related to accounting business rules, confidentiality, effective date, rate tables, content restrictions, and other differences. Notice at 5-8.

As noted by the Public Representative, several of the changes from the TNT Agreement are minor in nature and do not appear to affect functional equivalence. These include certain customer-specific information, customs inspection, and routing details. The Public Representative identifies other changes which he contends are substantially different from the baseline agreement, rendering the instant agreement non-functionally equivalent. These changes include the alternate optional inbound EMS rates, the absence of service performance metrics, and accounting business rules. PR Comments at 3-4, 6.

The Public Representative identifies noteworthy differences between the instant agreement and the TNT Agreement. Based on the information provided in this proceeding, however, the Commission is not persuaded that these differences warrant establishing the China Post 2011 Agreement as a new product at this time. First, while the accounting business rules may affect the effective date because of deliberations on terms, the effect should be relatively minor. The parties pledge to negotiate in good faith to develop rules applicable to the settlement process. Notice, Attachment 1 at 11.

Second, the China Post 2011 Agreement does include service performance metrics. More specifically, the instant agreement states that regarding the exchange of EMS items, the "service guarantees, targets and levels of achievement" of the Kahala

Post Group, are incorporated into the terms of the China Post 2011 Agreement. *Id.* at 12.

Among the changes, however, the most problematic is the alternate inbound EMS rates China Post could elect under the Agreement. The TNT Agreement contains no counterpart. The Postal Service, however, indicates that there is little likelihood of that election being made.⁸ Based on that representation, the Commission finds it unnecessary to establish the instant agreement as a new product.

Compliance with 39 U.S.C. 3633. The Commission reviews competitive products to ensure that they meet the applicable requirements of rules 3015.5 and 3015.7, and 39 U.S.C. 3633. The Commission has reviewed the Notice, financial analyses provided under seal that accompanies the instant contract, as well as the comments filed in this proceeding.

The supporting documentation suggests that the China Post 2011 Agreement will comply with 39 U.S.C. 3633, with rates yielding a modest cost coverage. As noted above, the instant agreement permits China Post to elect alternate inbound EMS rates. In its filing, the Postal Service neither explains the rationale for the alternative rate option nor quantifies their impact on revenue or costs. Should these rates be implemented, the Commission is concerned that the instant agreement may become non-compensatory.

As noted above, the Postal Service discounts the likelihood that the alternate rates would be triggered. *Id.* The Commission accepts this response, but cautions the Postal Service against the use of alternative rates that may negatively impact cost coverage. To the extent that future filings provide a similar alternate rate option, the rationale for the option and its impact on revenues, if implemented, must be supported in the Postal Service's initial filing.

The Postal Service's financial model for the instant agreement employs a smaller contingency factor than used in the TNT Agreement. The rationale for the smaller

⁸ Response of the United States Postal Service to Commission Information Request No. 1, September 6, 2011, question 2a.

contingency is not well supported. See *id.*, question 1. The goal of the contingency is to protect the Postal Service from unforeseeable circumstances that may impact cost. By lowering the contingency, the Postal Service increases the risk that the contract will be non-compensatory.

The financial model includes volume projections for inbound EMS, Air CP, and Surface CP and reflects a change in the mail mix from the previous contract period. If the change in mail mix does not occur, the likelihood that the contract will not cover its attributable costs increases, which, in turn, could give the Postal Service an unfair competitive advantage over its competitors.

Based on the information provided, the Commission finds that the contract submitted should cover its attributable costs (39 U.S.C. 3633(a)(2)), should not lead to the subsidization of competitive products by market dominant products (39 U.S.C. 3633(a)(1)), and should not have a negative effect on competitive products' contribution to institutional costs (39 U.S.C. 3633(a)(3)). Thus, a preliminary review of the instant contract indicates that it comports with the provisions applicable to rates for competitive products. The significance of the instant agreement to the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product warrants monitoring its financial performance closely.

Other considerations. The Postal Service shall notify the Commission of the effective date of the China Post 2011 Agreement. If the instant contract terminates earlier than scheduled, the Postal Service shall inform the Commission prior to the new termination date.

If the alternate inbound EMS rates become effective under the instant agreement, the Postal Service shall notify the Commission within 30 days of such election.

Within 30 days of the expiration of the instant contract, the Postal Service shall file costs, volumes, and revenues disaggregated by category of mail.

In conclusion, the Commission finds that the contract submitted in Docket No. CP2011-68 is appropriately included within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product.

V. ORDERING PARAGRAPHS

It is ordered:

1. The contract filed in Docket No. CP2011-68 is included within the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 (MC2010-34) product.
2. The Postal Service shall notify the Commission of the effective date of the instant contract and update the Commission if the contract terminates prior to the scheduled termination date as discussed in this Order.
3. Within 30 days of the expiration of the China Post 2011 Agreement, the Postal Service shall file costs, volumes, and revenues disaggregated by category of mail.
4. If the alternate inbound EMS rates become effective under the instant agreement, the Postal Service shall notify the Commission within 30 days of such election.

By the Commission.

Ruth Ann Abrams
Acting Secretary